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IN THE

Supreme Court of the United States

October Term, 1964

No. 912

In the Matter of

AZURE HILLS CLUB, INC.,

Bankrupt.

OLYMPIC FINANCE CO.,

Petitioner,

vs.

THOMAS R. THYRET, Trustee in Bankruptcy for Azure Hills Club, Inc., Bankrupt,

Respondent.

Petition for Writ of Certiorari to the Court of Appeals for the Ninth Circuit.

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vs.

THOMAS R. THYRET, Trustee in Bankruptcy for Azure Hills Club, Inc., Bankrupt,

Respondent.

/

Petition for Writ of Certiorari to the Court of Appeals for the Ninth Circuit.

Petitioner, Olympic Finance Co., prays that a writ of certiorari issued to review the judgment of the Court of Appeals for the Ninth Circuit herein affirming the order of the United States District Court for the Southern District of California, Central Division, which affirmed the order of the Referee in Bankruptcy denying Petitioner's petition for reclamation.

I.
OPINIONS BELOW.

No opinions were delivered by the Referee in Bankruptcy or the United States District Court. The opinion of the Court of Appeals for the Ninth Circuit is reported at 337 F. 2d 62.

II.
JURISDICTIONAL STATEMENT.

This matter was decided by the United States Court of Appeals for the Ninth Circuit on October 6, 1964.

An order denying a rehearing in that court was entered on November 19, 1964.

The jurisdiction of this Court is invoked under the provisions of the Bankruptcy Act, Section 24 c (11 U.S.C. 47 subd. c).

III.
QUESTIONS PRESENTED.

The entire evidence consisted of a stipulation and of documentary evidence including a note for the bankrupt's obligations to petitioner. This note, and the underlying written agreement on the basis whereof the note was made and given, both contained a recital of the facts of the transaction between the parties.

Under the laws of California there is a conclusive presumption of the truth of the facts so recited. Nevertheless, the Referee determined that the basic underlying agreement accomplished a novation between the parties, inconsistent with the recital; that title to equipment theretofore leased to the bankrupt passed to the bankrupt then already in dire financial embarrassment; and

that petitioner was left with a worthless unsecured obligation in lieu of its legal title to the equipment leased to the bankrupt.

In this state of the record, these questions are presented:

1. Whether the scope of review on appeal is so circumscribed that the Court of Appeals was bound by the Referee's conclusion (mistitled "Findings") and could not independently review the entire evidence to arrive at its own determination, bearing especially in mind that the present case posed no problems of weighing oral testimony or resolving any conflicting evidence.

2. Whether the burden of proving a novation by clear and convincing evidence, placed by state law on the party asserting it — the trustee in bankruptcy herein — may in effect be so shifted as to place a burden on petitioner to establish the absence of any novation. Careful analysis indicates that the decision of the Court of Appeals for the Ninth Circuit, if left to stand, may be a harbinger of a body of federal bankruptcy law of contracts out of harmony with the law of contracts of the state of California which in the first instance defined the legal meaning and effect of the obligations involved.

3. Whether it can be held as a matter of law that petitioner can be deprived of its legal title to the leased property and of the security which that title constitutes, without any evidence that it ever intended or consented to relinquish its legal title, and where, on the contrary, infinite care was

taken to differentiate between the loan transaction and the acquisition of the leases and where all title documents were delivered to and were and are still held by petitioner.

IV.

STATUTES AND RULES INVOLVED.

The following statutes and rules are involved:

Bankruptcy Act, Section 24 (11 U.S.C. Section 47);

Rule 52 (a) of the Federal Rules of Civil Procedure;

General Order in Bankruptcy Number 47;

California Civil Code, Section 1530;

California Civil Code, Section 1531.

These provisions, by reason of their length are set forth in Appendix 2 of this Petition.

V.

STATEMENT OF THE CASE.

This case arose from a Petition by Olympic Finance Co. ("Olympic", hereinafter) to reclaim personal property in the possession of the Trustee in Bankruptcy. The Referee denied the Petition, his Order was affirmed by the District Court and, in turn, by the Court of Appeals.

The District Court had jurisdiction by virtue of the Bankruptcy Act, Section 2, subdiv. a (10) and Section 39, subdiv. c (11 U.S.C. 11, 11 U.S.C. 67). The Court of Appeals for the Ninth Circuit had jursidiction by virtue of Section 24, subdiv. a and b of the Bankruptcy Act (11 U.S.C. 47).

On or about October 8, 1957, Azure Hills Club, Inc., the bankrupt ("Azure", hereinafter) as lessee entered into a lease with D. A. Financial Service Co. Inc. ("D. A. Financial", hereinafter) as lessor for certain restaurant equipment and personal property. The total rent, payable over eight years amounted to $269,336.62, payable $61,807.06 upon the commencement of the lease and thereafter at the rate of $5,764.71 per month [Exs. A and B]. At the same time, D. A. Financial granted to Azure an option to purchase the personal property, upon conclusion of the lease and subject to its faithful performance, for $5,639.36 [Ex. C].

Having concluded the foregoing lease, D. A. Financial on the next day, purchased the leased property from Interstate Restaurant Supply Co. ("Interstate", hereinafter). Subsequently, Interstate assigned its interest as conditional vendor to Bank of America, and D. A. Financial assigned to Bank of America its interest as conditional vendee and lessor [Ex. D].

Two months later, in December of 1957, another such four party transaction took place, for a somewhat lesser amount.

As a result of the foregoing transactions, and from and after December 19, 1957, Azure was subject to monthly rental payment obligations aggregating $6,212.56.

In 1959 Azure was over $32,000.00 in arrears under its monthly rental installments. Federal tax liens had been filed against it of record for some $45,000.00 plus interest and penalties and it was in imminent danger of losing its option rights to purchase the leased property.

Sometime prior to August 29, 1960, a loan broker acting as agent for Azure approached Olympic for a loan to ease Azure's financial plight. He presented to Olympic a proposal to make a $75,000.00 secured loan to Azure and Riverside Commissary Inc. ("Commissary", hereinafter) an affiliate of Azure. *This proposition was rejected by Olympic* [Stipulation *Re* Reopening Petitioner's Case, etc. R. 12-16].

A vastly different transaction was thereafter entered into, which is set forth in Exhibit F, being escrow instructions dated August 29, 1960. Olympic therein agreed to make a loan to Azure and Commissary in the net amount of $36,766.86, upon the security of a deed of trust on two parcels of real property, one being owned of record by Azure and the other by its affiliate Commissary.

Azure was faced with this situation: In order to be able to operate and to have a chance to rehabilitate itself financially, it had to have possession and use and the assurance of the continued possession and use, of all of the restaurant and club equipment subject to the leases. Azure was then deeply in arrears under the lease rental payment, and all of the remaining rental installments totalling $32,952.59 were payable [Ex. F, p. 3, 2d par., lines 4-5 thereof]. Azure was in imminent danger of losing the option rights to purchase the leased property. In the event of such loss, Azure would have been deprived of its equipment and would have been beyond hope of rehabilitation. Any loan to it would have been futile.

The problem was thus resolved: Olympic purchased and acquired from Bank of America the interest previously assigned to the latter by D. A. Financial, the

conditional vendee and lessor [Exs. J, L, M and N (1)]. Ivar, Olympic's subsidiary, acquired the title holder's interest [Exs. K and N (3)]. Thus Olympic and Ivar, collectively, succeeded to the position of Bank of America and D. A. Financial. The leases and conditional sales contracts were separately sold and assigned by proper documentation to Olympic and Ivar and said leases, conditional sales contracts and assignments and all other documentation involved were delivered to Olympic and Ivar respectively and *possession of all such documents remained with them at all times thereafter and still remain with them.*

Olympic, having thus stepped into the lessor's shoes agreed with Azure that

> ". . . the ($32,952.59) obligation of [Azure] under said [lease] agreements and for the option to purchase *may* be satisfied by a first payment of $644.64 beginning December 5, 1961 and nine equal monthly payments of $4,200.00, beginning January 5, 1962, with the last monthly payment due September 5, 1962, being the total sum of $38,444.64 . . ." (emphasis added) [Ex. F, p. 3, 2nd par. lines 7-11 thereof].

Azure was thus provided the *alternative, at its election,* to pay the leasehold and option payments on a deferred and stretched out basis commencing at a date one month after Azure was to have paid off the promissory note to Olympic [Ex. G].

In order to acquire the position of the Bank of America, Olympic paid out $32,952.59 and Ivar paid out $5,523.62, separate and apart from the loan to Azure [Exs. L, M and N (1); 21a examination, p. 18, line 20;

p. 19, line 13]. Azure executed a note for $62,355.36 [Ex. G], the amount thereof being explained as follows in the fourth paragraph of Exhibit G itself:

> "The obligation represented by the face amount of this note is arrived at in the following manner: Payee has loaned to payors the sum of $36,766.86; in addition to that, it has purchased Lessor's interest and the Titleholder's interest in certain Lease Agreement covering certain personal property, which said Lease Agreements, plus an amount sufficient to exercise an option to purchase said personal property, the latter two amounts totaling $38,444.64. The difference between the amount loaned hereunder and the amount of this note is a figure representing 2½% per month interest on $75,000.00"

The $62,355.36 note was secured by a deed of trust [Ex. H] and a mortgage of chattels of the leased property [Ex. I], the latter to encumber Azure's lessee's interest and its option to purchase. (It appeared unlikely, though conceivable, that Azure might pay off its leasehold obligations and exercise its option to purchase but default under the loan, in which case the security of the chattel mortgage would have become meaningful). Both the trust deed and the chattel mortgage recite that they were made and given to secure the $62,355.36 note.

It was the intent of the parties to keep the two transactions carefully separated. This is borne out by all the evidence on the subject including a stipulation of the parties. Olympic received written assignments of and possession of all the leases and title documents from Bank of America, and at all times retained them in its

possession. It never gave a bill of sale or title document of any kind to Azure, nor is there any evidence that Azure ever asked for any such bill of sale or document.

Azure subsequently fell into arrears even under the alternative plan allowing deferral of lease payments and ultimately filed its Petition in Bankruptcy.

VI.

ARGUMENT.

The Referee's Order Herein Amounts to a Substantial Departure From Established State Law.

Examination of the Referee's findings — more accurately to be called conclusions of law — requires application of the facts to the substantive law of California on the subject of novation of contracts, *with due regard* at the same time for the presumptions and for the allocation of the burden of proof, as established by and a part of the law of California.

In the first place, presumptions in California constitute *evidence* which, in the absence of opposing evidence, *compel* a determination in accordance with the presumption.

> *Smelley v. Southern Pacific Company,* 212 Cal. 540 (1931).

The burden of proving a novation is on the party asserting its existence (the trustee in bankruptcy here) and the proof in support thereof must be clear and convincing.

> *Ayoob v. Ayoob,* 74 Cal. App. 2d 236, 250 (1946);
>
> *Colley v. Cowchilla Natl. Bank,* 200 Cal. 760, 770 (1927).

The phrase "clear and convincing" has been defined as "clear, explicit and unequivocal," "so clear as to leave no substantial doubt" and "sufficiently strong to command the unhesitating assent of every reasonable mind."

In re Jost, 117 Cal. App. 2d 379, 383 (1953);
Witkin; Calif. Evidence, p. 78.

Otherwise stated, a preponderance calls for probability, while clear and convincing proof demands a high probability.

Witkin; Calif. Evidence, p. 79.

The question whether a novation has taken place is always one of intent. Specifically, it is the intent of the *obligee (i.e.* Olympic) which is *controlling* on the question whether there was an immediate and unconditional waiver or release or modification of the pre-existing obligations of the debtor (Azure), regardless of its future performance or the lack of it.

Ayoob v. Ayoob, 74 Cal. App. 2d 236, 251.

The record in the present case is barren on any evidence of intent by Olympic to divest itself of its title to the leased personal property under any circumstances whatever. In the face of voluminous and careful documentation, there is a total absence of any bill of sale or other document, however informal, that might tend to support a passage of title. All title documents and leases were retained by Olympic, and no request therefor was ever made by the debtor.

Under California law, the mere fact that the creditor agrees to accept some other performance in satisfaction of a different pre-existing obligation, is not sufficient to

prove that he intended to discharge that pre-existing obligation.

Bowden v. Bank of America, 36 Cal. 2d 406;
Williams v. Reed, 113 Cal. App. 2d 195, 201 (1952);
Williams v. Reed, 48 Cal. 2d 60;
Transport Clearing-Bay Area v. Simmons, 226 A.C.A. 513 (1964).

Attempting to find support for the theory of novation, the proposition is advanced that Azure became subject to obligations which did not exist theretofore. In this context, the permissive "may" is turned into the mandatory "must". Even if it were to be assumed for the sake of argument only, that this construction is tenable — which it is not — it still is unexplained why or how title passed. No evidence sustains the implicit finding that Olympic intended to pass title to Azure then and there, regardless of Azure's future performance or the lack of it.

But even the foregoing assumption, *made for purpose of argument only,* is not tenable: No authority is cited for the proposition that under circumstances such as prevail here, "may" can be turned into "must"; Azure's search has revealed no such authority in the law of California. Even if "construction" could so far change the plain meaning of words — which it can not —, still a novation is *precluded* by the conclusive presumption following from the recital of facts, contained in the escrow agreement and the note:

> ". . . payee has loaned to payor the sum of $36,766.86; in addition to that, it has purchased lessor's interest and the title holder's interest in certain lease agreements covering certain personal property . . ."

The written documents, prepared by the parties with obvious care, thus recite what took place, and how the parties arrived at their respective positions. Such recitals are *conclusive,* and allegations, findings, conclusions and judgments which are inconsistent therewith cannot stand.

California Code of Civil Procedure, Sec. 1962 (2);

Bowyer v. Burgess, 54 Cal. 2d 97;

Dabney v. Philleo, 38 Cal. 2d 60, 71-72;

Estate of Watkins, 16 Cal. 2d 794.

May it be reasonably assumed under the circumstances of this case, that Olympic, having refused to make a *secured* loan of $75,000.00 to Azure, acquires title to the personal property subject to the leases and thereupon promptly intends to, and does, transfer such title to Azure for an *unsecured,* nebulous and undefined sort of an obligation?

May it be reasonably assumed, in the circumstances of this case, that Olympic, having acquired title to the personal property subject to the leases and having retained in its possession the leases and all title documents nevertheless passed title to Azure without a bill of sale or other writing whatsoever, without even a word being spoken on the subject, and without any evidence that it was ever requested to give a bill of sale or transfer any documents?

May it be reasonably assumed from the mere fact that Olympic acquired title to the leased personal property to *protect and assure* Azure's continued possession thereof, to *protect* Azure's option to ultimately purchase such property, and from the fact that it afforded Azure an

alternative stretched-out plan for the payment of its obligations which it then appeared to have a chance to meet, — may it be assumed from all or any of the foregoing that Olympic intended to change, immediately and unconditionally, the relationship of lessor and lessee to one of vendor and vendee? Even if it were assumed for the sake of argument only that the stretched-out payment schedule was mandatory rather than obligatory, how would it follow that title has passed? Extended argument is not necessary for the proposition that the terms of payment under a lease could be changed without affecting title to the leased property.

Questions such as the foregoing are unanswered by the Court of Appeals' opinion. It becomes inescapable that, indeed, a mistake has been committed in stripping Olympic of its legal title.

Petitioner Was Deprived of the Full Scope of Appellate Review to Which It Is Entitled.

Section 24 of the Bankruptcy Act (11 U.S.C. Section 47) confers jurisdiction on the Courts of Appeals "to review, affirm, revise, or reverse, *both in matters of law and in matters of fact* . . ." (emphasis added). This special grant of appellate jurisdiction within the Bankruptcy Act itself is considerably broader than the grant of jurisdiction of the Courts of Appeals conferred by 28 U.S.C. 1291. It contains a specific grant of jurisdiction to review etc. "in matters of fact" which the general statute does not contain. The summary nature of bankruptcy proceedings may well explain the need for a higher degree and wider scope of appellate review than the one generally prevailing. The jurisdiction conferred

by the Bankruptcy Act itself governs appeals in bankruptcy matters.

> *Ackert v. Baltimore and O.R. Co.* (C.C.A. 4th, 1940), 115 F. 2d 455, 457 (fn. 1).

In the present case, the Court of Appeals felt itself circumscribed in the exercise of its jurisdiction thus conferred upon it, and thereby failed to give Petitioner its full review.

It is correctly pointed out in the opinion of the Court of Appeals for the Ninth Circuit that

> "Rule 52a of the Federal Rules of Civil Procedure prescribes that findings of fact in actions tried without a jury 'shall not be set aside unless clearly erroneous, and due regard shall be given to the opportunity of the trial court to judge of the credibility of the witnesses.' "

However, no witnesses testified here; hence there is no occasion for a judgment of credibility, and the record presents the pure question whether the referee's "findings" are "clearly erroneous" under the criterion heretofore laid down by this Honorable Court:

> "A finding is 'clearly erroneous' when *although there is evidence to support it,* the reviewing court *on the entire evidence* is left with a definite and firm conviction that a mistake has been committed" (emphasis added).
>
> *United States v. Gypsum Co.,* 333 U.S. 364, 395.

Due consideration of the evidence, and due application of the foregoing standard demonstrates that a mistake has indeed been committed. The effect of the mistake is

such that it transcends the confines of this case. Its impact extends way beyond the immediate parties. If left to stand, it will amount to a retreat from principles of appellate review hitherto thought well established in this area of federal law and practice. The Court of Appeals for the Ninth Circuit recognized that it had jurisdiction but felt the necessity for restraint in its exercise in deference to the referee's expertise. If such restraint is to narrow the review provided by statute (Bankruptcy Act Section 24, 11 U.S.C. 47) by rule (F.R.C.P. 52a) and by decisions of Courts of Appeals (some of which are cited hereinafter) then the law is certainly in need of clarification.

There is a body of law, both in the Ninth Circuit and elsewhere, to the effect that the "clearly erroneous" standard of Rule 52a, and of General Order in Bankruptcy Number 47, does not inhibit an *independent* consideration of the *entire evidence* where, as here, no questions of credibility are involved.

Carr v. So. Pacific Co., 128 F. 2d 764 (9 Cir.);

Costello v. Fazio, 256 F. 2d 903 (9 Cir., 1958);

In re Pioch, 235 F. 2d 903 (3 Cir.).

It is well settled that General Order No. 47 does not apply to conclusions of law.

Namoff v. Hyland Electrical Supply Company, 275 F. 2d 14, 16, cert. den. 364 U.S. 818;

Walker v. Com. Bank of Little Rock, 217 F. 2d 677 (8 Cir.);

Utley v. United States, 304 F. 2d 746, 750 (9 Cir.).

If orders of a referee, based on documentary evidence and stipulations alone, are not entitled to *full* review, both in the district court and on appeal, then the scope of appellate review has been drastically narrowed.

The precedental value of the opinion of the Ninth Circuit herein, if left to stand, will greatly discourage attempts to rehabilitate debtors in distress by means short of proceedings in bankruptcy. Presently, the financial community acts in the reliance that any security right or interest defined by state law will be accepted and recognized as such in bankruptcy. If the judgment in this case stands, then such reliance can be reposed no longer.

In essence, Olympic acquired property subject to pre-existing leases, succeeded to the position of the lessor, and gave the lessee an opportunity to defer and extend payments. Under the laws of California, this falls far short of the necessary showing of an intent to accomplish an immediate and unconditional novation. If such were to be the rule in bankruptcy proceedings, then a different end result would obtain, depending on whether the question of novation is presented in the state or the federal forum. Any non-recognition of state-law created security instruments will certainly discourage suppliers of fresh funds to ailing enterprises. The commercial risks of an attempted rehabilitation of a distressed debtor are quite enough without adding the legal hazard that the creditor's rights might vanish in bankruptcy. It is respectfully submitted that the considerations of public policy here involved are of such importance as to warrant the granting of the writ of certiorari for which this petition is made.

VII.

CONCLUSION.

For the foregoing reasons it is respectfully submitted that this Petition for a Writ of Certiorari should be granted.

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APPENDIX I.

Opinion in the Court of Appeals for the Ninth Circuit.

United States Court of Appeals, For the Ninth Circuit.

Olympic Finance Co., Appellant, vs. Thomas R. Thyret, Trustee in Bankruptcy for Azure Hills Club, Inc., Bankrupt, Appellee. No. 18,874.

[October 6, 1964]

Appeal from the United States District Court for the Southern District of California Central Division.

Before: Barnes, Circuit Judge; Madden, Judge, United States Court of Claims; and Merrill, Circuit Judge.

Barnes, Circuit Judge:

This case arises on appeal from a district court affirmance of a referee's order denying Olympic Finance Company's petition of August 16, 1962 to reclaim certain personal property from the trustee in bankruptcy. Olympic Finance Company (herein referred to as "Olympic") asserted its right to the property on the ground that the bankrupt, Azure Hills Club, Inc., (herein referred to as "Azure") had defaulted on its rental payments to Olympic, the assignee of the personal property lease agreements. The order denying the petition based its findings on the existence of a novation in the form of an escrow agreement of August 29, 1960. This novation extinguished all prior rights and obligations of the parties with respect to the personal property lease agreements as well as certain conditional sale contracts covering the same personal property. The court

below had jurisdiction. 11 U.S.C. § 11(a)(10). So have we on this appeal. 11 U.S.C. § 47.

The events leading up to the escrow agreement of August 29, 1960 (the alleged novation) are as follows:

On October 8, 1957, a personal property lease agreement was entered into between D. A. Financial Service Co., Inc., lessor (herein referred to as "D. A. Financial"), and Azure, lessee. The lease period was eight years and the rent amounted to $269,336.62, payable $61,807.06 on October 8 and $5,764.71 on November 10, 1957, and each successive month up to and including October 10, 1960. D. A. Financial also granted Azure an option to purchase the personal property for $5,639.36.

The following day, October 9, 1957, D. A. Financial made a conditional sale purchase from Interstate Restaurant Supply Co. of the property it had leased the day before.

Later that month, Interstate assigned its interests as conditional sales vendor to Bank of America. D. A. Financial also assigned to Bank of America its interests in the October 8 lease with Azure.

An identical four-party transaction was consummated for a somewhat lesser amount of personal property in December 1957.

On August 29, 1960, an agreement was executed by Olympic, Azure and Riverside Commissary, Inc. (an affiliate of Azure) entitled "Borrower's and Lender's Escrow Instructions and Agreement." Pursuant to this agreement, the leases and contracts described above were to be purchased by Olympic. Azure executed to Olympic a promissory note for $62,355.36; a deed of trust

securing said note; and a chattel mortgage on the personal property in question. The amount of the promissory note was calculated as follows:

> "Payee has loaned to payors the sum of $36,766.86; in addition to that, it has purchased Lessor's interest and the Titleholder's interest in certain Lease Agreements covering certain personal property, which said Lease Agreements are badly in default, for an amount represented by payors to be equivalent to the balance of its obligation under said Lease Agreements, plus an amount sufficient to exercise an option to purchase said personal property, the latter two amounts totaling $38,444.64. The difference between the amount loaned hereunder and the amount of this note is a figure representing 2.5% per month interest on $75,000.00."

On September 6, 1960, Olympic purchased and acquired from Bank of America the interest previously assigned to the latter by D. A. Financial, the conditional vendee and lessor. Ivar Investment Co., Olympic's wholly-owned subsidiary, acquired the title holder's interest. Olympic paid $32,952.59 and Ivar paid $5,523.62. These amounts were in addition to the $62,355.36 promissory note executed by Azure.

Repayment of the principal paid by Olympic and Ivar for the interests in the personal property was to be made under the following deferred payment plan:

> ". . . the [$32,952.59] obligation of [Azure] under said [lease] agreements and for the option to purchase may be satisfied by a first payment of $644.64 beginning December 5, 1961 and nine equal monthly payments of $4,200.00, beginning

January 5, 1962, with the last monthly payment due September 5, 1962, being the total sum of $38,444.64. . . ."

On July 25, 1962, Azure filed its petition in bankruptcy and was adjudicated a bankrupt. On September 19, 1962, Olympic filed its reclamation petition.

On these facts recited the following questions are presented:

1. Does the escrow agreement of August 29, 1960 constitute a novation?

a. What was the parties' intent concerning the effect of the obligations created by the escrow agreement on prior obligations?

b. Does Ivar's separate corporateness preclude a finding of a novation?

c. Does the written language of the deferred repayment plan preclude a finding of a novation?

d. Does appellant's evidence in the form of a colloquy between counsel preclude a finding of a novation?

2. In the event this court determines the escrow agreement did not constitute a novation, what is the respect this court must extend to the referee's finding, affirmed by the district court?

We conclude the decision of the referee, affirmed by the district court, should be affirmed.

The question of whether or not the escrow agreement of August 29, 1960 was a novation of the preexisting contractual obligations between Olympic and Azure must rest upon the facts of the case. They could unquestionably lead reasonable men to opposite conclusions. But there were substantial changes in the rights

and obligations of the parties evolving from the escrow agreement of August 29, 1960. These cause us to conclude a novation occurred. The existence or absence of a novation is determined inferentially, when not specifically, by the trier of fact. Whether a strict or liberal approach to the scope of appellate review is applied, this court should follow the decision of the referee, affirmed by the trial judge, where the facts allow reasonable men to differ in conclusion.

1—What constitutes a novation?

The California Civil Code § 1530 defines a novation as follows: "Novation is the substitution of a new obligation for an existing one." The trustee's argument, adopted by the referee and district court, was that the escrow agreement of August 29, 1960 was a novation, discharging Azure from its obligations under the personal property lease agreements and conditional sales contracts. Appellant, to the contrary, points to the continued existence of Azure's rental obligations and its consequent defaults in rental payments to the appellant — the present possessor of the leasehold interests. This default, asserts the appellant, entitles Olympic to reclaim the personal property in question.

No definitive formula exists to distinguish a mere contractual modification from a novation. Section 1531 of the California Civil Code states: "Novation is made: 1. By the substitution of a new obligation between the same parties, with intent to extinguish the old obligation. . . ." A somewhat more elaborate judicial

definition was given by the California courts in *Young v. Benton*, 21 Cal. App. 382, 131 P. 1051 (1913):

> "Novation . . . implies four essential requisites: 1. A previous valid obligation; 2. The agreement of all the parties to the new contract; 3. The extinguishment of the old contract; and 4. The validity of the new one." *Id.* at 384.

In the more recent case of *Alexander v. Angei*, 37 C.2d 856, 236 P.2d 561 (1951), a further allusion was made to the difficulty of defining a novation:

> "While the evidence in support of a novation must be 'clear and convincing' . . ., the 'while question is one of fact and depends upon all the facts and circumstances of the particular case' . . ., with the weight and sufficiency of the proof being matters for the determination of the trier of the facts under the general rules applicable to civil actions." *Id.* at 860-61.

In the light of the above, we note that case precedent is not helpful in assessing whether a novation has been consummated; each case is resolved on the basis of its own fact pattern. For example, in *Bowden v. Bank of America*, 36 C.2d 406, 224 P.2d 713 (1950), the bankrupt purchased a number of motor vehicles for business use with the assistance of a variety of financial arrangements with defendant bank. After a partial reduction of the indebtedness, at the request of the bankrupt, the entire liability was consolidated into one promissory note, secured by a single chattel mortgage. The bank did not seasonably record the mortgage, but when the bankrupt defaulted under the note, the defendant bank took possession of the vehicles. The trustee

claimed that the consolidation in a single note and chattel mortgage effected a novation, and defendant's delinquency in recording precluded it from reclaiming the vehicles. On this fact situation, in the absence of new debts and obligations, the California Supreme Court held the consolidation was not a novation. Similarly, in *National Pacific Oil Co. v. Watson,* 184 Cal. 216, 193 P. 133 (1920), after it was discovered that immediate possession could not be given under a contract for the sale of land, a rearrangement relating to the matter of payments was not considered a novation of the contract.

But the California courts have found the existence of a novation on the basis of a particular factual setting, rather than any governing legal precedent. *Simmons v. Sweeny,* 13 Cal. App. 283 (1910) involved an action by a real estate broker to recover damages for breach of a written contract to pay one-third of all profit from a sale of land at $19,000. The court found that this written contract was superseded by a subsequent oral contract by which the broker was permitted to sell the land at auction; the owner was to receive $21,000 and the broker anything in excess. The court in this situation determined the oral contract was a novation because the terms of the two contracts were so entirely inconsistent, and could not possibly be operative at the same time.

Further examination of case precedent seems unnecessary to substantiate the premise that whether or not a novation exists will depend primarily upon the individual facts of each case.

II—The effect of the escrow agreement.

To determine whether the escrow agreement here involved was intended to have the legal effect of a novation, it is necessary to contrast the respective rights and obligations of the parties before and after the effective date of this instrument. Prior to August 29, 1960, Azure had the following financial burden under the lease agreements and purchase option:

1. Lease of 10/8/57 — Payment of $5,764.71/mo.
2. Lease of 12/9/57—Payment of $447.85/mo.
3. Option to buy personal property for $5,280.50.

Subsequent to August 29, 1960, a number of substantial changes appeared in the respective rights and obligations of the parties:

1. A new $62,355.56 promissory note was executed. This note included a newly created consideration of 2.5 per cent per month interest, not only on the amount of the loan but also on the amount paid out by Olympic and Ivar to acquire the personal property leases and title holders' interests.

2. Repayment of the principal amounts expended by Olympic and Ivar were deferred until the entire amount due on the promissory note was repaid. Monthly rental payments thus ceased, and were replaced by monthly payments on a promissory note which included an interest charge on the total amount of the deferred rental payments.[1]

[1]To illustrate this point with an example: It can be assumed that prior to the escrow agreement rental payments in the sum of $10,000 remained due, to be paid in equal $1,000 installments over the following ten months. Subsequent to the agreement, payment of this $10,000 would be deferred until after repayment of a newly consummated loan; yet $250 (2.5%) additional interest charge per month would commence immediately as a result of the deferral

3. The option to purchase the personal property was converted into a legal commitment for Azure. The deferred payment schedule included an amortization of the amount Azure previously could have elected to pay to exercise its option rights.

4. As additional factors, to secure the promissory note, Azure was required to execute a chattel mortgage on the personal property involved, and Azure and Commissary were required to execute a deed of trust on their respective pieces of real property. Additionally, new penalty provisions for prepayment or delinquent payment were incorporated in the promissory note.

Although no one of the above factors, standing alone, might be sufficient to turn a contractual revision into a novation, when all are considered as a unit in contrasting the rights and obligations of the parties prior to the escrow agreement, and after it, the intent of the parties as evidenced by the agreement would reasonably appear to be to extinguish the former obligations, and to replace them with a new set.

III—The separate corporate existence of Ivar and Commissary.

The separate corporate existence of Ivar and Commissary, parties to the escrow agreement, separate and apart from Olympic and Azure respectively, is not persuasive in negating the existence of a novation. To disregard the essence of a transaction on the basis that a party chose to use as his agent a separate corporate entity would be to disregard reason and promote an injustice. The referee found that Ivar acted as agent for its parent. And the parties themselves, in the promissory note, in the escrow agreement, and even in open court, treated

Olympic and Azure alone as the principals to the transactions involved.

IV—The language of the deferred payment plan.

Under the deferred payment plan, Azure was to satisfy its obligation to Olympic under the lease agreements and option to purchase after it had satisfied its liability on the promissory note. The escrow agreement states that the obligation "may be satisfied by the payments of a first payment of $644.64 beginning January 5, 1962, with the last monthly payment due September 5, 1962, being the total sum of $38,444.64. . . ." Counsel for appellant laid great emphasis on the precatory nature of the word "may" in this provision. Such a permissive reference, it was asserted, could hardly serve as a new obligation, completely superseding the old. This argument is not persuasive when the word "may" is read in context. It strains reasonable reading of the provision to construe it as permissive rather than mandatory. Read in context, this permissive word assumes the stature of a legal obligation.

V—Colloquy between counsel.

For the first time, appellant contends on appeal that a colloquy between counsel at the proceedings of December 7, 1962 served as a stipulation conclusively proving the continuing operation of the 1957 lease agreements. To resolve this controversy on the basis of a verbal exchange in court where it was not readily apparent stipulation was actually being entered into would serve only to avoid the very issue of the case. The colloquy referred to by appellant can be interpreted as presentation of appellant's evidence on the question of intent,

with counsel for appellee offering no more than token resistance to the admission of such evidence. It seems apparent from the record (Vol. II of December 7, 1962, pp. 1-3), as well as appellant's failure to raise this colloquy at any earlier stage, that had counsel for the appellee realized a stipulation was intended for the proposition now urged, the proceedings might well have continued in a different light.[2]

The facts of this colloquy differ markedly from the stipulations made in *Burstein v. United States,* 232 F. 2d 19 (8th Cir. 1956), relied on by appellant. . . that case a controversy arose as to the cost and quantity of yards of material needed to manufacture certain articles of clothing. The parties *expressly stipulated* one set of figures before the trial court, and this set was unequivocally adopted on appeal by the court. There was no area of doubt in the mind of either counsel as to the facts stipulated to before the trial judge. Such a clear factual situation does not here exist.

VI—Scope of judicial review.

If the escrow agreement of August 29, 1960 in fact is deemed to be a novation, the question of the scope of the appellate court's review becomes a moot one. But, if one were to deduce from the facts of the case that a novation did not occur, the question of the proper scope of judicial review would necessarily arise.

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[2]The stipulation was not that there was "a continuing operation of the 1957 agreement," as now urged, but that after the escrow agreement date of August 29, 1960, "Olympic never requested payment of rent on leases between Azure and Interstate." Counsel for trustee: "We don't say that Olympic didn't ask for payment under this agreement. We say they did not ask for payment specifically in the amounts called for by the leases." Counsel for Olympic: "I would stipulate to that."

Rule 52(a) of the Federal Rules of Civil Procedure prescribes that findings of fact in actions tried without a jury "shall not be set aside unless clearly erroneous, and due regard shall be given to the opportunity of the trial court to judge of the credibility of the witnesses." The United States Supreme Court further refined this standard in *United States v. Gypsum Co.*, 333 U.S. 364 (1948) when it stated:

> "A finding is 'clearly erroneous' when although there is evidence to support it, the reviewing court on the entire evidence is left with the definite and firm conviction that a mistake has been committed." *Id.* at 395.

Much can be said in the case at hand for a higher degree of appellate review in light of the absence of any need to judge the credibility of witnesses before the referee; the reviewing court is in an equally advantageous position to make factual inferences from an agreed-upon set of events. Yet it seems incumbent to exercise some degree of judicial restraint in regard for the expertise of the referee in bankruptcy. The ninth circuit has exercised such restraint. In *Costello v. Fazio*, 256 F.2d 903 (9th Cir. 1958), the court noted the greater area for review when credibility was not in question:

> "Where a finding of fact by the referee is based upon conflicting evidence, or where the credibility of witnesses is a factor, a district court and, on appeal, a court of appeals will seldom hold such a finding clearly erroneous. The same reluctance is not encountered with regard to a factual conclusion from given facts. In the latter case, the proper conclusion from given facts can be made by the trial judge, or the court of appeals, as well as the referee." *Id.* at 908.

Yet, in reversing the decision of the referee, the court in *Fazio* chose to do so only by holding the finding of the referee "clearly erroneous."

The *Fazio* rule was somewhat amplified and the extent of judicial restraint was articulated in the case of *Hoppe v. Rittenhouse,* 279 F.2d 3, 9 (9th Cir. 1960):

> "The rule applied in Fazio is pertinent where the primary facts can fairly be said to admit of but one reasonable conclusion, and yet this principle does not change the equally settled rule that where the basic and undisputed facts are fairly susceptible of diverse inferences requiring different conclusions, the determination made by the trier of fact is conclusive on review unless that finding is 'clearly erroneous'."

In addition, General Order in Bankruptcy No. 47, by adopting "clearly erroneous" language, seems to encourage an exercise of a considerable degree of judicial restraint. 11 U.S.C. § 53.

Finding no error, we *Affirm.*

APPENDIX II.

Statutes and Rules Involved.

BANKRUPTCY ACT, SECTION 24 (11 U.S.C. 47)

§ 24. *Jurisdiction of Appellate Courts.* a. The United States court of appeals, in vacation, in chambers, and during their respective terms, as now or as they may be hereafter held, are hereby invested with appellate jurisdiction from the several courts of bankruptcy in their respective jurisdictions in proceedings in bankruptcy, either interlocutory or final, and in controversies arising in proceedings in bankruptcy, to review, affirm, revise, or reverse, both in matters of law and in matters of fact: *Provided however,* That the jurisdiction upon appeal from a judgment on a verdict rendered by a jury shall extend to matters of law only: *And provided further,* That when any order, decree, or judgment involves less than $500, an appeal therefrom may be taken only upon allowance of the appellate court.

b. Such appellate jurisdiction shall be exercised by appeal and in the form and manner of an appeal.

c. The Supreme Court of the United States is hereby vested with jurisdiction to review judgments, decrees, and orders of the United States courts of appeals in proceedings under this Act in accordance with the provisions of the laws of the United States now in force or such as may hereafter be enacted.

RULE 52 (a) OF THE FEDERAL RULES OF CIVIL PROCEDURE

(a) *Effect.* In all actions tried upon the facts without a jury or with an advisory jury, the court shall find the facts specially and state separately its conclusions of law thereon, and judgment shall be entered pursuant to Rule 58; and in granting or refusing interlocutory injunctions the court shall similarly set forth the findings of fact and conclusions of law which constitute the grounds of its action. Requests for findings are not necessary for purposes of review. Findings of fact shall not be set aside unless clearly erroneous, and due regard shall be given to the opportunity of the trial court to judge of the credibility of the witnesses. The findings of a master, to the extent that the court adopts them, shall be considered as the findings of the court. If an opinion or memorandum of decision is filed, it will be sufficient if the findings of fact and conclusions of law appear therein. Findings of fact and conclusions of law are unnecessary on decisions of motions under Rules 12 or 56 or any other motion except as provided in Rule 41(b).

GENERAL ORDER IN BANKRUPTCY NUMBER 47

Reports of Referees and Special Masters

Unless otherwise directed in the order of reference the report of a referee or of a special master shall set forth his findings of fact and conclusions of law, and the judge shall accept his findings of fact unless clearly erroneous. The judge after hearing may adopt the report or may modify it or may reject it in whole or in part or may receive further evidence or may recommit it with instructions.

CALIFORNIA CIVIL CODE, SECTIONS 1530 and 1531

§ 1530. NOVATION, WHAT. Novation is the substitution of a new obligation for an existing one.

§ 1531. MODES OF NOVATION. Novation is made:

1. By the substitution of a new obligation between the same parties, with intent to extinguish the old obligation;

2. By the substitution of a new debtor in place of the old one, with intent to release the latter; or,

3. By the substitution of a new creditor in place of the old one, with intent to transfer the rights of the latter to the former.

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IN THE

Supreme Court of the United States

October Term, 1964

No. 912

In the Matter of

AZURE HILLS CLUB, INC.,

Bankrupt

OLYMPIC FINANCE CO.,

Petitioner,

vs.

THOMAS R. THYRET, Trustee in Bankruptcy for Azure Hills Club, Inc., Bankrupt,

Respondent.

BRIEF FOR RESPONDENT IN OPPOSITION.

Statement of the Case.

We have no hesitancy in adopting the summary of the facts of this case as set forth in the Opinion of the Court of Appeals for the Ninth Circuit. Respondent will not for that reason present its own Statement of the Case in this brief. (App. I of Petition pp. 2-4.)

Before turning to a discussion of the points raised by petitioner, however, we would like to point out certain misstatements made by petitioner in its "Statement of the Case", and its obvious attempt to editorialize

the facts. For example, on page 6 of the Petition, we find the following:

> "Sometime prior to August 29, 1960, a loan broker acting as agent for Azure [the bankrupt] approached Olympic [the petitioner] for a loan to ease Azure's financial plight. He presented to Olympic a proposal to make a $75,000.00 secured loan to Azure and Riverside Commissary Inc. ('Commissary', hereinafter) an affiliate of Azure. *This proposition was rejected by Olympic* [Stipulation Re Reopening Petitioner's Case, etc. R. 12-16]."

An examination of the stipulation referred to shows that it was entered into for the sole purpose of introducing into evidence, over the objection of the trustee, a further document, and that the stipulation was entered into on the statements from counsel for petitioner to counsel for the respondent as to who prepared the document and at whose request. [Record 12-13.] There is no evidence in the record to support the quoted statement of the petitioner herein.

Petitioner in editorializing its "Statement of the Case" makes the following statement regarding the very transactions involved in the Agreement of August 29, 1960 (hereinafter referred to as the "Agreement"), before the court and the intent of the parties in executing such Agreement:

> "It was the intent of the parties to keep the two transactions carefully separated. This is borne out by all the evidence on the subject including a stipulation of the parties." (Petition, p. 8.)

Again, no authority is cited to support this statement. The intent of the parties in executing the Agreement was an issue of fact and this issue was decided adversely to petitioner.

Petitioner, even in its "Questions Presented", takes liberties with the facts. For example, the following statement is made:

> ". . . Nevertheless, the Referee determined that the basic underlying agreement accomplished a novation between the parties, inconsistent with the recital; that title to equipment theretofore leased to the bankrupt passed to the bankrupt then already in dire financial embarrassment; and that petitioner was left with a *worthless unsecured obligation* in lieu of its legal title to the equipment leased to the bankrupt." (Emphasis added—Petition, pp. 2-3.)

Petitioner would have the court ignore the fact that Azure was obligated to pay it over $100,000.00 pursuant to the Agreement of August 29, 1960 [Ex. F.] and that pursuant to that Agreement, Azure executed a chattel mortgage on substantially all the personal property involved herein. [Ex. I.] In addition, petitioner further ignores the fact that Azure and a stranger to the original transactions, Riverside Commissary, Inc., pursuant to the Agreement, secured petitioner's promissory note [Ex. G] by executing deeds of trust on their respective parcels of real property. Payment of all sums owed to petitioner under the Agreement was subject to "provisions regarding prepayment, penalties for delinquent payments and early payments" as set forth in the note secured by the Trust Deeds. [Ex. F, p. 3.]

Petitioner would have the Court rectify its business judgment in entering into the Agreement which is the subject of this litigation because of the events occurring subsequent to the execution of the Agreement.

Petitioner's Statement of the Case is truly not a statement of the case, but only an argument for its position in this matter.

ARGUMENT.

The issues in the present case are uniquely narrow ones, and do not warrant review by this Court on certiorari. This case was resolved on the basis of its own facts according to the law of the State of California, and will affect no others than the parties. Petitioner in order to receive another hearing exaggerates the importance of this case to create an issue for review, but no amount of editing of the facts of this case can create an issue which would bring it within the standards set forth in Rule 19 of this Court for the granting of a writ of certiorari.

The precedental impact of the Circuit Court of Appeals' Opinion will not disturb the "financial community" as argued by the petitioner, for the reason that the Court's Opinion is based on the peculiar facts of the case. (App. I of Petition, pp. 8-9.) Also, there are no considerations of public policy here involved to warrant the granting of the writ of certiorari for which the petition is made.

I.

The Decision Below Is Clearly Correct.

The Court of Appeals in its Opinion states that the California Courts have found the existence of a novation on the basis of a particular factual setting, rather than any governing legal precedent, and that whether a novation exists will depend primarily upon the individual facts of each case. (App. I of Petition, p. 7.) For example, the California Supreme Court in *Alexander v. Angel,* 37 Cal. 2d 856, 236 P. 2d 561 (1951) stated:

> "While the evidence in support of a novation must be 'clear and convincing' . . ., the 'whole question is one of fact and depends upon all the facts and circumstances of the particular case' . . ., with the weight and sufficiency of the proof being matters for the determination of the trier of the facts under the general rules applicable to civil actions," *Id.* at 860-61.

As set forth in the Opinion of the Court of Appeals, the facts of each case are determinative of whether there was a novation. The trier of facts made a finding that there was a novation and that the rights and obligations of the parties were replaced by new ones pursuant to the Agreement.

Petitioner would have the Court ignore the difference of the rights and obligations of the parties prior and subsequent to the execution of the Agreement. The Court of Appeals after contrasting the respective rights and obligations of the parties before and after the exe-

cution of the agreement which extinguished the old obligations and created new ones, concluded:

> "Although no one of the above factors, standing along, might be sufficient to turn a contractual revision into a novation, when all are considered as a unit in contrasting the rights and obligations of the parties prior to the escrow agreement, and after it, the intent of the parties as evidenced by the agreement would reasonably appear to be to extinguish the former obligations, and to replace them with a new set." (App. I of Petition, pp. 8-9.)

Despite the fears of the petitioner that the decision in this case may be a "harbinger of a body of federal bankruptcy law of contracts out of harmony with the law of contracts of the State of California" (Petition, p. 3), no such horrendous conclusion can be drawn from the Opinion of the Court of Appeals. Petitioner exaggerates the impact of the ruling in this case when it implies that the decision will affect attempts to "rehabilitate debtors in distress", and that the "financial community" might act in reliance thereon. It requires no great legal acumen to make certain that there be no question of "novation." All that the drafter of a document needs is a provision setting forth specifically that the new agreement does not contemplate an extinguishment of the old obligation or the creation of a new one. The failure to so provide in the provisions of the documents in the instant case and the conduct of the parties under the Agreement evidently impressed the Referee, the District Court and the Court of Appeals. It ill-befits the petitioner at this juncture to create a monster for the purpose of arousing groundless fears.

II.

An Appeal Based on the Hope That an Appellate Court Will Second-Guess the Trial Court Does Not Warrant the Exercise of the Supreme Court's Power of Supervision.

A reading of the Court of Appeals' Opinion shows how carefully the Court considered and reviewed the facts of the case at bar. Petitioner's contention that it was deprived of the full scope of appellate review is without merit. The basis of petitioner's argument is that when the credibility of witnesses is not passed upon by the trier of facts, an appellate court should ignore the decision of the trial court and hear the case *de novo*. This is clearly not the law where conflicting inferences may be drawn from the established facts by reasonable men and the inferences drawn by the trial court are those which could have been drawn by reasonable men.

Lundgren v. Freeman, 307 F. 2d 104, 113-115 (9th Cir. 1962);

Commissioner of Internal Revenue v. Duberstein, 363 U.S. 278, 289-291 (1960).

The purpose of judicial review should not be used to encourage appeals that are based on the hope that an appellate court will second-guess the trial court. Petitioner attempts, for the third time, to have a court decide the merits of this case in its favor by granting a trial *de novo*.

Even if it be assumed that there is a conflict between petitioner and respondent as to the proper scope

of judicial review and the application of the "clearly erroneous" rule where the trial court has not judged the credibility of witnesses, the decision below should be affirmed in the absence of any disclosure in the record that a mistake has been committed. In this case, the Court of Appeals in affirming the lower court's decision did not find that a mistake had been committed, a standard for reversal promulgated by this Court in *United States v. Gypsum Co.*, 333 U.S. 364, 395 (1948).

Conclusion.

For the foregoing reasons it is respectfully submitted that this Petition for a Writ of Certiorari should be denied.

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